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BEFORE THE  
FEDERAL COMMUNICATIONS COMMISSION  
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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

In the Matter of

Price Cap Performance Review  
for Local Exchange Carriers

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CC Docket No. 94-1

REPLY COMMENTS OF THE  
NYNEX TELEPHONE COMPANIES

The NYNEX Telephone Companies

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## SUMMARY

The Commission instituted this proceeding to consider whether the price cap plan for LECs should be revised "to better serve the goals of the Communications Act and the public interest in the years ahead." As expected, this proceeding has generated intense interest in the telecommunications industry. NYNEX, and many others, demonstrated that, while the existing price cap plan has provided significant benefits, fundamental reform of the Commission's price cap and access charge rules is required to achieve the Commission's policy goals in the years ahead. However, some parties, principally the LECs' competitors, would have the Commission revise its price cap plan in a manner that would reduce incentives for LEC investment. They also urge the Commission to continue the regulatory constraints that prevent LECs from meeting the access competition that is growing at a phenomenal rate. These comments demonstrate that these parties would have the Commission take a step backward in its price cap regulation of LECs. The Commission can realize its goal of stimulating the development of an efficient and modern telecommunications infrastructure only if it adheres to a strict timetable for the reform of its price cap and access charge rules.

In Section II of the comments, we respond to those parties who propose that further access reform should be postponed. The parties advocating that position suggest that access competition is minimal, and that LECs have the ability and incentive to disadvantage competitors and thus keep

competition from emerging. These parties are wrong. Access competition, particularly in NYNEX's region, is strong and growing. NYNEX has both competitors and competition. The growth of competition requires that the Commission revise the price cap and access charge rules in order to promote regulatory parity between the LECs and their competitors.

In Section III, we respond to those parties who contend that the LECs should be denied increased pricing flexibility. Rather than constraining the LECs' pricing flexibility, the Commission should adopt a regulatory regime that affords the LECs pricing flexibility commensurate with the degree of competition being faced in particular markets. Necessary reforms include revised and simplified price cap baskets and bands and significantly increased pricing flexibility for LECs subject to competition.

Section IV demonstrates that the arguments of some parties that reform of the Commission's new services rules is unnecessary are without merit. We also respond to the arguments of several parties that new, even more restrictive pricing rules should be imposed on the LECs. The Commission's new services rules should instead be revised so that LECs can price those services at a level that rewards them for innovation. In this way, the Commission can meet its goal of encouraging the introduction of new and innovative services while ensuring reasonable rates.

In Section V, we respond to those parties who argue that (i) both the sharing and low-end adjustment mechanisms should be retained; or (ii) only the low-end adjustment mechanism should be eliminated. The Commission should reject these positions and eliminate both the sharing and low-end adjustment mechanisms. A pure price cap model, such as that enjoyed by AT&T and the LECs' cable competitors, should be adopted by the Commission.

Section VI demonstrates that the arguments of several parties that the productivity factor contained in the price cap rules should be increased are without merit. The LECs' earnings levels do not warrant either an increase in the price cap formula's productivity factor, or a one-time reduction in rates. Rather, LEC earnings during the price cap period, including those of NYNEX, have been entirely reasonable. Moreover, a one-time reduction in rates would be inappropriate because, by recapturing LEC productivity gains, the Commission would be reducing the LECs' incentives for efficiency, innovation and investment.

In Section VII, we demonstrate that there is no basis for a one-time price cap reduction or a realignment of the low end adjustment or sharing mechanism to reflect capital costs. The evidence in this proceeding demonstrates that the Commission's currently prescribed interstate access rate of return of 11.25% is below, rather than above, a zone of reasonable cost of capital estimates. Furthermore, since the

11.25% rate of return and low end adjustment/sharing mechanism parameters were prescribed by the Commission under Section 205 of the Communications Act, any retrospective change of those prescriptions would constitute unlawful retroactive ratemaking.

In Section VIII of the comments, we respond to those parties who propose that the Commission significantly scale back its recognition of exogenous costs in the price cap formula. There is no basis for curtailing the allowability of exogenous costs. The proposals made by these parties are unfair to LEC shareholders and contrary to the incentive basis of price cap regulation.

This is a time of unprecedented change in the telecommunications industry. New service providers are proliferating and competition is growing rapidly. Moreover, the Clinton Administration has indicated its desire for a National Information Infrastructure. It is critical that the Commission revise its price cap plan to provide the LECs with the necessary investment incentives and regulatory flexibility so that the goals of the Administration and the Commission may be achieved.

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The NYNEX Telephone Companies<sup>1</sup> ("NYNEX") hereby submit their reply comments in response to the Commission's Notice of Proposed Rulemaking ("NPRM"), released February 16, 1994 in the above-captioned proceeding.

I. INTRODUCTION

The Commission instituted this proceeding to consider whether the price cap plan for LECs should be revised "to better serve the goals of the Communications Act and the public interest in the years ahead."<sup>2</sup> As expected, this proceeding has generated intense interest in the telecommunications

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<sup>1</sup> The NYNEX Telephone Companies are New York Telephone Company ("NYT") and New England Telephone and Telegraph Company ("NET").

<sup>2</sup> NPRM at para. 4.

industry.<sup>3</sup> NYNEX, and many others, demonstrated that, while the existing price cap plan has provided significant benefits, fundamental reform of the Commission's price cap and access charge rules is required to achieve the Commission's policy goals in the years ahead. However, some parties, principally the LECs' competitors, would have the Commission revise its price cap plan in a manner that would reduce incentives for LEC investment. They also urge the Commission to continue the regulatory constraints that prevent LECs from meeting the access competition that is growing at a phenomenal rate. These comments will demonstrate that these parties would have the Commission take a step backward in its price cap regulation of LECs. The Commission can realize its goal of stimulating the development of an efficient and modern telecommunications infrastructure only if it adheres to a strict timetable for the reform of its price cap and access charge rules.

In Section II of the comments, we respond to those parties who propose that further access reform should be postponed. The parties advocating that position suggest that access competition is minimal, and that LECs have the ability and incentive to disadvantage competitors and thus keep competition from emerging.<sup>4</sup> These parties are wrong. Access competition, particularly in NYNEX's region, is strong and growing. NYNEX has both competitors and competition. The

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<sup>3</sup> A list of the parties that submitted comments in this proceeding is attached as Attachment A.

<sup>4</sup> For example, Teleport states that "[c]ompetitors we have, competition we lack." (Teleport at p. i.).



growth of competition requires that the Commission revise the price cap and access charge rules in order to promote regulatory parity between the LECs and their competitors.

In Section III, we respond to those parties who contend that the LECs should be denied increased pricing flexibility. Rather than constraining the LECs' pricing flexibility, the Commission should adopt a regulatory regime that affords the LECs pricing flexibility commensurate with the degree of competition being faced in particular markets. Necessary reforms include revised and simplified price cap baskets and bands and significantly increased pricing flexibility for LECs subject to competition.

Section IV demonstrates that the arguments of some parties that reform of the Commission's new services rules is unnecessary are without merit. We also respond to the arguments of several parties that new, even more restrictive pricing rules should be imposed on the LECs. The Commission's new services rules should instead be revised so that LECs can price those services at a level that rewards them for innovation. In this way, the Commission can meet its goal of encouraging the introduction of new and innovative services while ensuring reasonable rates.

In Section V, we respond to those parties who argue that (i) both the sharing and low-end adjustment mechanisms should be retained; or (ii) only the low-end adjustment mechanism should be eliminated. The Commission should reject these positions and eliminate both the sharing and low-end adjustment mechanisms. A pure price cap model, such as that

enjoyed by AT&T and the LECs' cable competitors, should be adopted by the Commission.

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In Section VII, we demonstrate that there is no basis for a one-time price cap reduction or a realignment of the low end adjustment or sharing mechanism to reflect capital costs. The evidence in this proceeding demonstrates that the Commission's currently prescribed interstate access rate of return of 11.25% is below, rather than above, a zone of reasonable cost of capital estimates. Furthermore, since the 11.25% rate of return and low end adjustment/sharing mechanism parameters were prescribed by the Commission under Section 205 of the Communications Act, any retrospective change of those prescriptions would constitute unlawful retroactive ratemaking.

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costs. The proposals made by these parties are unfair to LEC shareholders and contrary to the incentive basis of price cap regulation.

This is a time of unprecedented change in the telecommunications industry. New service providers are proliferating and competition is growing rapidly. Moreover, the Clinton Administration has indicated its desire for a National Information Infrastructure. It is critical that the Commission revise its price cap plan to provide the LECs with the necessary investment incentives and regulatory flexibility so that the goals of the Administration and the Commission may be achieved.

## II. ARGUMENTS THAT ACCESS COMPETITION IS MINIMAL ARE WITHOUT MERIT

Several parties argue that the LECs face no competition and that further access reform should be postponed indefinitely by the Commission. These parties claim that the competitive threat to the LECs is "imaginary" because the LECs allegedly control 99% of the interstate access market.<sup>5</sup> They also argue that the competitive threat from cable companies and wireless technologies is not imminent.<sup>6</sup> Some parties argue that the LECs should be afforded no increased pricing flexibility until certain conditions for local exchange competition have been met.<sup>7</sup> These parties are incorrect on all counts.

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<sup>5</sup> MFS at p. 39.

<sup>6</sup> AT&T at p. 12.

<sup>7</sup> MFS at pp. 40-50; MCI at pp. 67-72.

The competitive threat to the LECs is hardly imaginary. While it may be true that interstate access competition is not ubiquitous throughout the country, it is sufficiently prevalent to warrant the access reform and additional pricing flexibility proposed by NYNEX. The degree of competition in the NYNEX region is particularly substantial. Competition in the NYNEX region is intense. Moreover, the NYNEX experience demonstrates that competitors need not, as some parties seemingly suggest, deploy their facilities throughout a LEC's territory in order to provide effective competition. The CAPs, such as MFS and Teleport, have concentrated their networks in high density, urban areas in NYNEX's region with large concentrations of business customers.<sup>8</sup> The City of New York, for example, where several CAPs have extensive networks, generates \$5 billion of NYNEX's telecommunications revenues, which is half of NYNEX's total telecommunications revenues and 5 percent of all LEC revenues. There are more Fortune 500 companies in New York than anywhere in the United States, and virtually all of them are served by competitors of NYNEX.<sup>9</sup>

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<sup>8</sup> In addition to New York City, the CAPs have operational networks in New York in Westchester County, Long Island, Albany, Buffalo and Syracuse. They have also been active in New England, with networks in the Boston metropolitan area, Springfield, Massachusetts and in several sections of Vermont. CAP networks are also planned for Providence, Rhode Island and Nashua, New Hampshire.

<sup>9</sup> A reason why lower Manhattan has the highest concentration of CAP services is that even though it constitutes only 0.3 percent of the land area in New York, the area provides 30 percent of NYNEX's business revenues in New York State. LATA 132, representing the New York City metropolitan area, provides almost 80 percent of NYNEX's

The claim that LECs still control over 99% of the interstate access market is clearly not the case in the NYNEX region.<sup>10</sup> These claims are supported by the argument that, nationwide, only about 1% of the IXCs' total interstate access charges are paid to CAPs.<sup>11</sup> This argument, however, ignores all competition other than CAP competition.<sup>12</sup> Competition in the NYNEX region arises from a variety of sources, including interexchange carriers, CATV, microwave, VSAT and private networks.<sup>13</sup> Considering all of these sources of competition, NYNEX's total interstate access market share is, in fact, less

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9 (Footnote Continued From Previous Page)

switched access revenues in New York State. (See "An Overview of the New York Competitive Marketplace," NYNEX, November 1993 and "The State of Competition in the NYNEX Region," prepared by NYNEX Access Services, December 1993.) Furthermore, business loops in Manhattan are about 100 times more dense than in New York City generally, and over 2000 times more dense than in upstate New York. A switch placed in Manhattan can reach many more customers more economically than a switch placed in almost any other location in the country.

10 AT&T at pp. i and 9; ALTS at p. 13; MFS at p. 39; Teleport at pp. 16 and 20; MCI at p. 65.

11 See "The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers", Economics and Technology, Inc./Hatfield Associates, Inc. This report, which was sponsored by AT&T, MCI and CompTel, was released February 15, 1994.

12 Furthermore, while market share is not, in any event, the most appropriate measurement of market power, these parties' use of estimated nationwide LEC market share is clearly meaningless. The aggregation of market shares in areas where there is little or no competition with areas like New York City where alternative access services are readily available and competition is strong, produces a totally misleading picture of the competitive landscape.

13 Attachment B depicts the various sources of competition faced by NYNEX.

than 85%.<sup>14</sup> Moreover, NYNEX's market share in many important market segments is far smaller.<sup>15</sup>

Several parties incorrectly characterize the extent of competition offered by cable and other companies. AT&T, for example, states that, "[n]o cable operator offers any service that is a substitute for traditional exchange telephone service anywhere in the US today.... Cable telephony is years away."<sup>16</sup> In its Comments, NYNEX demonstrated the extent to which cable companies, interexchange carriers and cellular companies provide services that compete with those offered by NYNEX.<sup>17</sup> That demonstration is simply ignored by these parties. Moreover, AT&T's assertion is particularly surprising, and disingenuous, in light of its alliance with Cablevision, which has been providing local telephone and cable service to several large customers on Long Island, including the State University at Stony Brook and North Shore University Medical Center. Cablevision, in conjunction with AT&T, is also providing local, long distance and cable service to Long Island University's C.W. Post campuses. Furthermore, Cablevision

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<sup>14</sup> NYNEX's estimate is based on a total market demand methodology, based on a number of studies. Attachment C demonstrates market share by minutes of use.

<sup>15</sup> For example, NYNEX's customer surveys show that the CAPs have acquired approximately 40 percent of the Special Access/private line market in the New York Metropolitan area. See Expanded Interconnection with Local Telephone Company Facilities, 7 FCC Rcd 7369 (1992), n.410, citing NYNEX surveys.

<sup>16</sup> AT&T at p. 12.

<sup>17</sup> NYNEX at pp. 16-18.

clearly has ambitious plans for further expansion. Cablevision has already completed a network of 500 miles of fiber capable of delivering phone service and video on demand to cable subscribers on Long Island and in New York City and plans to install an additional 3000 miles of high capacity fiber.<sup>18</sup>

Several parties argue that, regardless of the level of interstate access competition, LECs should be afforded no increased pricing flexibility until certain conditions for local exchange competition have been met. In particular, AT&T, MFS, Teleport and ALTS suggest lengthy lists of conditions as prerequisites for increased pricing flexibility. These parties argue that the local exchange represents a "bottleneck", and until that bottleneck is broken full interstate access competition is not possible.

As NYNEX has demonstrated in this proceeding, and in a variety of other proceedings, interstate access competition is a reality. The development of interstate access competition has not depended on local exchange competition. Moreover, as one party correctly noted, "[t]he Commission must also recognize ... it is competition for interstate access services that should be the Commission's focus [in this proceeding]. Competition in other areas of telecommunications is irrelevant to the LEC price

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<sup>18</sup> Wall Street Journal, October 27, 1993 at p. B4. It is also important to note that Teleport has extended its networks in New York and Massachusetts by using the fiber facilities of its parent cable companies. Moreover, Time Warner has announced that it will use its cable television facilities in Rochester to provide telephone service to residential and business customers. (New York Times, May 18, 1994, at p. A1.)

cap plan."<sup>19</sup> Nonetheless, to the extent local exchange competition is a relevant consideration in determining whether access reform is warranted, the conditions listed by these parties have almost all been met in New York and most have been met, or are expected to be met this year in Massachusetts. Changes in technology, as well as actions by the NYPSC, have eliminated all barriers to entry.

First, changes in technology during the last decade have helped to eliminate any bottleneck. The CAP industry now operates extensive local transmission networks in most major cities because fiber optic technology allows them to provide transmission services more efficiently than with copper based technology. Once a fiber optic cable is installed between two points (e.g., between an MFS central office and an office or apartment building), it has virtually unlimited capacity, depending on the speed of the multiplexing equipment that is connected on each end.<sup>20</sup> The efficiency of fiber optics makes it unnecessary for a CAP to duplicate the copper network that formed the basis for the LEC network at divestiture.

The introduction of digital switching technology has also played a part in enabling the CAPs to enter the local

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<sup>19</sup> OCCO at p. 12.

<sup>20</sup> For example, a one-half inch thick fiber cable normally contains 64 fiber strand pairs. Using 45 Mbps speed multiplexers, a carrier can derive 43,000 voice grade channels from such a cable, which is equivalent to the capacity of twelve 3-inch thick copper cables. The same fiber cable can carry 516,000 circuits if 560 Mbps speed multiplexers are used, while it would take 144 3-inch thick copper cables to provide the same capacity.



telephone market. The CAPs use the same switches as the LECs, and have the ability to provide services with the same features and functions as a LEC provides. Thus, the CAPs are now able to offer, and indeed do offer, substitutes for the existing landline telephone distribution system. Once a CAP has installed fiber to a particular building, it is in a position to carry all of the traffic that can be generated to or from that building.

Second, the NYPSC has taken the lead in promoting competition for local exchange services by eliminating barriers to entry and by taking the actions necessary to confer local telephone company status on over 20 of NYNEX's competitors, including the CAPs. It has also encouraged NYNEX to unbundle its services and to provide new forms of interconnection so that the CAPs can provide all forms of service to both the IXC's and end user customers.<sup>21</sup>

To confirm that the legal, regulatory, technological, and economic barriers to entry into the local exchange market have been eliminated, one need only look at the competitive situation in New York. There are alternative providers of dialtone service in New York. Companies such as MFS and Teleport are both free to resell NYNEX telephone service and/or to provide their own dialtone service in Manhattan, as the NYPSC has granted them certificates that enable them to offer all forms of service in New York, including local exchange

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<sup>21</sup> See NYNEX at pp. 14-16.

service.<sup>22</sup> Furthermore, there has been significant entry and investment in local switching capacity for local service in New York City and the surrounding area. Of the approximately 500,000 business loops in Manhattan, about 150,000 could be served by MFS, Teleport or LOCATE alone.<sup>23</sup> In addition, other customers could be served by switches that are out of the area, such as Cablevision's switch on Long Island. Local telephone company status allows these firms to use their switching capacity exactly as would any other LEC.

Moreover, local exchange competition is not limited to the New York City metropolitan area. In November 1993, ACC Corp. announced its intention to enter the local exchange market using a new digital switching and fiber optic transmission network in upstate New York. The company expects to begin providing local service to residential and business customers in June 1994 in Buffalo, Rochester, Syracuse, Albany, Binghamton and other towns and cities in the 716, 315, 607 and 518 area codes. According to Richard T. Aab, chairman and CEO of ACC Corp.:

With over 50,000 ACC Long Distance customers in the region, we're in a strong position to begin offering high-quality local service to customers who want state-of-the-art technologies at reasonable prices. Our installed base of 49

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22 MFS has also announced that it plans to upgrade its networks in Albany, Buffalo and Westchester County to provide dialtone service.

23 MFS employs an Ericsson AXE switch with an estimated capacity of 40,000 lines. Teleport employs two AT&T 5ESS switches with an estimated capacity of 40,000 lines each. LOCATE planned to have a capacity of 30,000 lines by the end of 1993.

universities and colleges in New York already using our long distance services represents an immediate market opportunity for ACC's local service offering.<sup>24</sup>

Additional competitors are on the horizon. MCI, which has been certificated by the NYPSC to provide all forms of local exchange service, recently announced its plans to spend \$2 billion to construct local exchange access facilities in markets throughout the country, including New York City, Boston and other cities in the NYNEX region.<sup>25</sup>

The suggestion by several parties that increased pricing flexibility should be postponed for some transition period is premised on the assumption that immediate access reform is not necessary because competition in the interstate access market will develop slowly, as it did in the long distance market.<sup>26</sup> The assumption is clearly wrong. Rather, it is likely that the LECs will quickly lose market share as competition intensifies. Unlike the Commission's experience with the growth of interLATA competition, NYNEX's competitors, such as the CAPs, IXC's and cable providers are experienced, well-established and well-funded with modern networks already in place. Moreover, in order to gain a significant share of the interstate access market a competitor need only target a few customers, rather than millions of individual customers located throughout the nation. Currently, 88 percent of NYNEX's

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<sup>24</sup> ACC News Release, November 17, 1993.

<sup>25</sup> See "MCI Proposes a \$20 Billion Capital Project," Wall Street Journal, January 5, 1994 at p. A3.

<sup>26</sup> Teleport at p. 28.

interstate access revenues are derived from three customers - AT&T, MCI and Sprint. NYNEX's share of the interstate access market could decline rapidly as these major customers transfer significant volumes of business to CAPs and other competitors, or replace NYNEX provided interstate access services with their own facilities.

In fact, several recent examples clearly demonstrate that increasing access competition will produce significant, rather than gradual declines in LEC market share. In March 1993, the Commission granted a waiver to permit Teleport and any other CAP to obtain expanded interconnection from NYNEX to fulfill pre-existing contracts to provide switched transport to IXCs.<sup>27</sup> In response, one CAP submitted a list of 340 Special Access DSIs and over 11,000 voice grade switched access trunks to be rolled over from NYT's Local Transport services to the CAP's collocated transport services. Over 90% of these facilities have already been transferred. In a second example, a large IXC is currently disconnecting over 1100 DSIs (which are equivalent to over 26,000 voice grade circuits) in Manhattan that are used for switched transport and is transferring that business to a CAP. These DSIs represent approximately half of the total number of switched DSIs at the IXC's two POPs in Manhattan.<sup>28</sup>

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<sup>27</sup> See Emergency Petition for Declaratory Ruling or, Alternatively, Petition for Waiver filed by Teleport Communications Group, 8 FCC Rcd 2578 (1993).

<sup>28</sup> This carrier has also advised NYNEX that it intends to transfer approximately 25 DS3s to a CAP in Boston.

In sum, interstate access competition is strong and is increasing. There is no need for further delay in revising the Commission's price cap and interstate access rules to provide LECs with the investment incentives and regulatory flexibility necessary to compete effectively.

**III. THE ARGUMENTS THAT LECs SHOULD BE DENIED INCREASED PRICING FLEXIBILITY ARE DESIGNED TO LIMIT COMPETITION AND SHOULD BE REJECTED**

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Despite the fact that the competitive situation clearly warrants increased pricing flexibility, several parties argue that the LECs already have sufficient pricing flexibility.<sup>29</sup> For example, MCI "believes that the current composition of [price cap] baskets gives the LECs adequate pricing flexibility to respond to any emergence of competition for those services that potential competitors are beginning to offer."<sup>30</sup>

These parties are incorrect.<sup>31</sup> While the price cap

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<sup>29</sup> In fact, several parties argue that the LECs have too much pricing flexibility (See CompTel, ICI, MFS, WilTel). In particular, they argue that LEC trunking rates and volume and term discount rates are discriminatory, despite the fact that these rates have been permitted to go into effect after extensive debate by all parties. These parties should not be allowed to renew these arguments in this proceeding.

<sup>30</sup> MCI at p. 16. See also Ad Hoc at p. 17 ("Generally, price cap LECs already possess sufficient pricing flexibility.")

<sup>31</sup> This is not a surprising reaction from the LECs' competitors. Their interests lie in minimizing their own regulations while having those imposed on the LECs continued or even increased. This allows the CAPs to target the most profitable market segments, while the LECs are prevented by regulatory restrictions from competing on an equal basis.

baskets and bands, and zone density pricing, have provided LECs with a minimum level of pricing flexibility, that level of flexibility is inadequate. Unlike their competitors, LECs cannot respond to specific customer needs with individually tailored solutions. Furthermore, the tariff filing and approval process puts the LECs at a disadvantage relative to their CAP competitors.

MFS argues that the existing system of pricing categories and subindices in the trunking basket should be replaced by a "cost consistency" test, pursuant to which the prices of individual LEC trunking services would be required to be justified on the basis of underlying direct costs.<sup>32</sup> MFS' argument should be rejected. MFS' "cost consistency" test is nothing more than a return to rate of return regulation. Moreover, it would be an enormous, and unnecessary, administrative burden for the LECs and the Commission to examine the incremental costs for every existing rate element within the trunking basket.

Rather than further constraining the LECs' pricing flexibility, the Commission should instead implement a mechanism to provide NYNEX and the other LECs pricing flexibility commensurate with the level of competition in particular markets. As NYNEX has demonstrated, the USTA Proposal<sup>33</sup> represents an excellent framework for determining when increased

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<sup>32</sup> MFS at pp. iii-iv.

<sup>33</sup> See In the Matter of Reform of the Interstate Access Rules, RM-8356, Petition for Rulemaking, filed September 17, 1993 ("USTA Proposal").

pricing flexibility should be permitted in response to competition.<sup>34</sup> As even NYNEX's competitors concede, the degree of competition varies from area to area.<sup>35</sup> Regulation must reflect those differences in market conditions. As markets become competitive, LECs should be allowed increased structural and pricing flexibility. The LECs' competitors already have virtually unlimited pricing flexibility, and have been able to exploit this advantage to garner substantial shares in some markets.

It is important to note that the USTA Proposal, if adopted, would not automatically provide LECs with increased pricing flexibility for all of their services throughout their service areas. Rather, the USTA Proposal provides a framework which can be utilized as a transition mechanism to provide increased pricing flexibility as a market becomes more competitive. The USTA Proposal would initially designate all areas as Initial Market Areas, within which there would be no additional pricing flexibility. Only after a showing that there was competition in an area would an area be designated a Transitional Market Area, entitling a LEC to increased pricing flexibility. A further competitive showing would be required to obtain the greater flexibility afforded in Competitive Market Areas, those subject to the most significant competition.

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<sup>34</sup> NYNEX at pp. 19-23.

<sup>35</sup> "[T]he degree of competition varies from place to place.... [S]ince the basic technology used by competitors -- fiber optic facilities -- is best suited to high volume, high density applications, not surprisingly competitive networks have tended to develop in areas with business and commercial properties." (Teleport at p. 27.)

Several parties assume that the USTA Proposal would allow LECs to use less competitive services, including local exchange services, to cross-subsidize competitive services. These suggestions are without merit. Jurisdictional separation between state and interstate services precludes any price movement between local services and interstate access services. Moreover, under the USTA Proposal, services offered in Transitional Market Areas, those areas where competition is developing, are banded together separate and distinct from services offered in Initial Market Areas, the areas in which competition is least intense. Furthermore, since Competitive Market Area services would, under the USTA Proposal, be totally outside the price cap framework, it would not be possible to offset decreases in competitive services with increases in other services still under price cap regulation.

Finally, rather than replacing the current structure of baskets and bands with an even more restrictive structure, based on "cost consistency" or some other test, the Commission should instead simplify the structure in accordance with the USTA Proposal.<sup>36</sup> If the Commission does not adopt the USTA Proposal for implementation in 1995, it should, at a minimum, reduce the banding constraints in the trunking basket, as proposed by NYNEX.<sup>37</sup> At the very least, the current DS1 and

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<sup>36</sup> See NYNEX at p. 25.

<sup>37</sup> Id. at pp. 25-26.



DS3 banding restrictions for trunking services should be removed.<sup>38</sup>

IV. PROPOSALS TO MAINTAIN THE INFLEXIBILITY OF THE NEW SERVICES RULES WOULD IMPEDE THE INTRODUCTION OF NEW AND INNOVATIVE SERVICES

The Commission has recognized that its new services rules can be unnecessarily restrictive and burdensome and hence discourage the introduction of new services as well as disadvantage LECs.<sup>39</sup> A number of parties, however, recommend that the Commission maintain lengthy notice periods for new services tariffs,<sup>40</sup> and restrict further the pricing of new services.<sup>41</sup> As discussed below, these recommendations would not serve the public interest.

Several parties, primarily the LECs' competitors, argue that the current 45-day notice period is necessary for review of LEC new service filings, does not impede the LECs in offering new services, and does not disadvantage LECs as compared to competitors. The facts demonstrate otherwise. In January 1994, NYNEX introduced "Performance Plus", pursuant to which NYNEX offered new and significant service guarantees to its customers. When NYNEX filed the tariff for Performance

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38 Alternatively, NYNEX also supports the proposal by Bell Atlantic (Bell Atlantic at p. 21) to remove high capacity services from price cap regulation. BellSouth's proposal for zone pricing for local switching (BellSouth at p. 31) should also be considered by the Commission.

39 NPRM at para. 79.

40 E.g., Teleport.

41 ICA, MCI, MFS, Teleport, WilTel.